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Betting Billions on North Sea Oil

DUN'S BUSINESS MONTH

FEBRUARY 1986 $3.00

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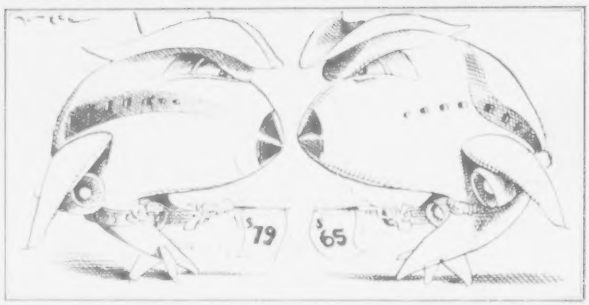

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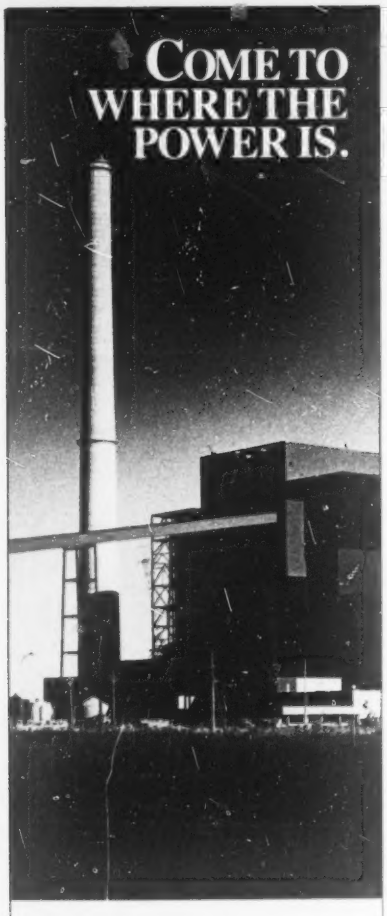

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LETTERS

ECONOMIC INDICATORS

Your article "The Leading Indicator Blues" (*November*) did not exactly cheer me up, but it does spur me on to do something to rectify the indicators' faults. However, at some points you pushed the argument too far:

1) Although the index may be overweighted towards manufacturing, seven of the twelve indicators are not oriented that way. 2) Although the index was not constructed to forecast GNP, it does in fact have a pretty good record in doing so. 3) Although the index gets revised a lot, we found that even the preliminary figures generated useful signals of recession and recovery. 4) Although the new business formation series is statistically deficient because of changes in the availability of relevant figures, it does not depend on answers to surveys.

We are beginning to work on a number of improvements in the leading index. In my view, it has served too well for too many years to abandon it now.

GEOFFREY H. MOORE
Director
Center for International Business Cycle Research
Columbia University Graduate School of Business
New York, N.Y.

A PLUG FOR THE COAST GUARD

The article "Transportation: Dole Confronts the Tough Issues" (*November*), while informative, made only one casual mention of the Coast Guard. The Coast Guard deserves better, as it constitutes a rather large segment of the Department of Transportation and is vital to this nation in carrying out law enforcement at sea, maritime safety and wartime readiness missions.

The Coast Guard is facing a severe crisis, with a proposed $230 million reduction in its operating budget for fiscal 1986. There have been drastic cutbacks in personnel, ships, aircraft and stations. With the expansion of missions imposed on it by Congress, the consequences could be serious.

RALPH J. DIVERIO
Maywood, N.J.

THE JOB MARKET

I enjoyed the article "Mergers Shake Up the Job Market" (*November*). The comments by the various search firms appear to be very much on target and consistent with the marketplace.

HOWARD E. REGAN
Foster City, Calif.

THE NEW WILKES-BARRE

I read with interest your article on the economic development efforts of towns of 100,000 or less ("Small Towns Plan Big," *October*). Like the cities profiled, Wilkes-Barre, Pennsylvania (population: 51,155) has aggressively jumped into the competition for new industry. The grimy-little-coal-town image is finally being shed.

EDWARD SCHECTER
Executive Director
The Committee for Economic Growth
Wilkes-Barre, Pa.

DIVIDEND ACHIEVERS

There were several errors in the "Dividend Achievers" tables in the December issue:

Premier Industrial Corp., excluded because of an error in the data base, would have ranked 91st with a growth rate of 17.6%. Central Carolina Bank was inadvertently dropped from the data base because of its recent name change to CCB Financial Corp.; it has raised its dividend for 21 consecutive years. Citizens Utilities Co., while listed in the tables, was excluded from the list of "Top Ten All-Time Dividend Achievers," where it would have ranked second with 41 years of increases.—Ed.

Address Letters to LETTERS EDITOR, Dun's Business Month, 875 Third Ave., New York, N.Y. 10022

Betting Billions On North Sea Oil

While prices tumble, North Sea producers are making a huge commitment to finding new oil. They expect it to pay off, too.

by David Fairlamb

While world oil prices plummet and pessimists warn of a coming price war, European and American oil companies are pouring more money than ever before into exploring and developing new oil fields in the climatically inhospitable, expensive-to-exploit North Sea. According to recent estimates, a record-breaking £8 billion-plus will be spent between now and 1990 to bring new fields on line in the British sector and another £3 billion will be spent in Norwegian waters.

Among other projects: Shell Oil plans to spend £2.3 billion developing the Gannet and Kittiwake fields; Shell and Exxon, a joint £910 million on the Tern field; British Petroleum and Conoco, a joint £1.4 billion on the Miller field; and Phillips Petroleum, £700 million on the Tiffany field. On top of that, North Sea companies will spend an annual £3 billion over the next five years on equipment and services to further develop their existing fields—an increase of 25% over recent levels. "We're embarking on a period of excitement and expectation offshore," says Alick Buchanan-Smith, British minister of state for energy. Kaare Kristiansen, his Norwegian counterpart, agrees.

This ambitious program, of course, seems to fly in the face of economic reason. World oil prices are tumbling precipitously and could fall to as low as $15 a barrel this spring. And over the next few years, analysts now estimate, the price of oil will average less than $22 a barrel.

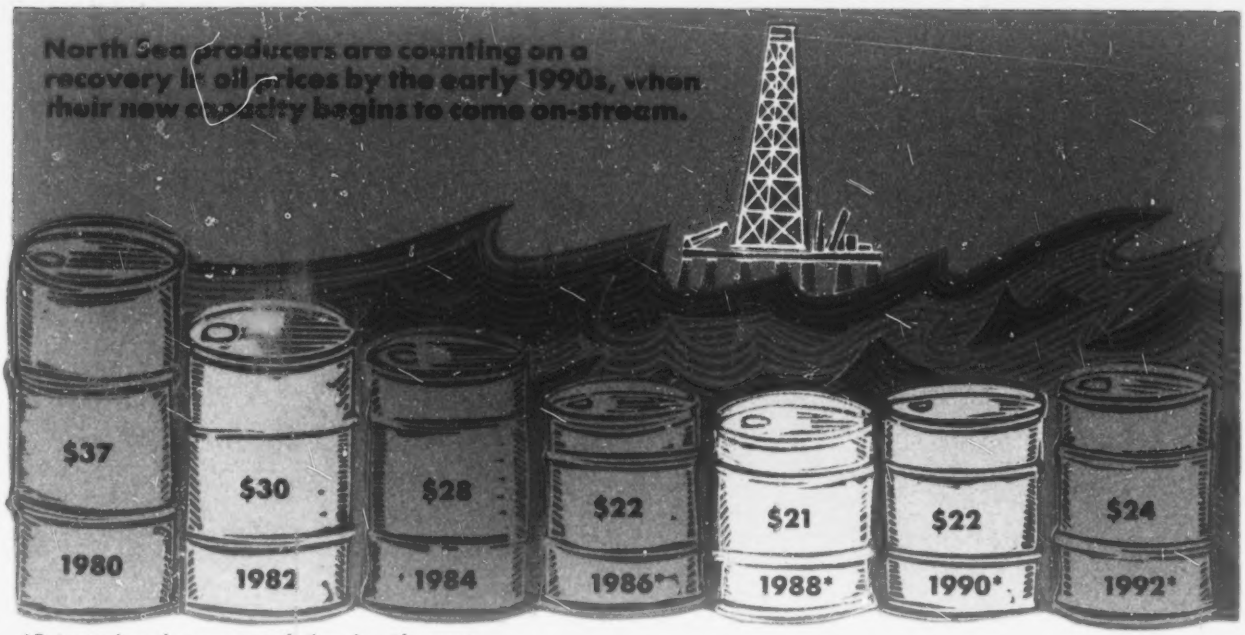
Thus, oil company margins will narrow sharply, and no area stands to be more adversely affected than the North Sea, where costs are among the highest in the world. While it costs $2-to-$5 to pump an average barrel of oil in Saudi Arabia, Indonesia and Texas, the cost mushrooms to $9 a barrel in the North Sea. And the British Department of Energy calculates that costs could rise as high as $18 a barrel for some of the new North Sea oil fields currently being developed in the deep waters of the far north on the borders of the Arctic Ocean.

Given costs like that, the whole of the North Sea is marginal, according to British oil analysts. Take the Tern field, for example. In a pessimistic scenario, oil analysts calculate that if oil is selling at $20 a barrel in 1990, Shell and Exxon would end up with a thumping £150 million loss on their new joint investment. "It frightens me to think what will happen if the Saudis push prices below the $20 level," admits one American oil executive based in Stavanger, Norway's picturesque oil capital.

Yet most of the North Sea oil companies seem confident that their current investment strategy is the right one. And ultimately they expect to realize a handsome return on investment.

Their optimisim is due partly to the financial advantages of operating in the North Sea. Although the margin between production costs and sales revenues is narrower than elsewhere, the oil companies' cost of delivery to major markets in Western Europe is relatively low. They also benefit from the comparatively attractive British and Norwegian tax and royalty structures. As the margin between costs and revenues narrows, the producers' tax and royalty payments fall too, which means that the British and Norwegian governments shoulder most of the burden of falling prices. "As long as the companies cover their operating costs, they can still make money," says Olivier Fremond, an oil analyst at London securities firm Wood, Mackenzie.

Moreover, to encourage new North Sea exploration, two years ago the British government offered the oil companies a tax holiday until 130% of their development costs are recouped, a move that



*Estimates based on average of oil analysts' forecasts.

helped kindle many of the new exploration projects. It was a big carrot in persuading Shell and Exxon to go ahead with their Tern development, says Peter Everett, managing director of Shell Expro, the joint venture set up to exploit the field.

Figures from Britain's Central Statistical Office show that North Sea companies' average return on investment hit a record 11.6% last year, despite the market's weakness. And an executive of one of the major oil companies in the region reveals: "With present prices, we average just over $1 clear on every barrel of North Sea oil we produce. That's just a few cents less than our take from most of our Middle East oil fields."

Of course, the record commitment to North Sea exploration and development is partly a strategic response to OPEC's weakness. As Sir Peter Walters, chairman of BP, explains: "The large multinationals are wresting control of oil markets from OPEC by building up supplies which they themselves control."

Humphrey Harris, oil analyst at British securities firm Fielding, Newson-Smith, further points out that it will probably be easier to market North Sea oil than Middle East oil in the buyer's market now emerging. "In a market characterized by almost total price flexibility," he contends, "political considerations could well rival commercial criteria in determining the source of a major buyer's crude supplies."

But the key factor that most of the oil companies take into account in shaping their investment policies is a recovery in oil prices. Most oil analysts believe that prices will begin to recover at the end of the decade (*chart*)—as demand picks up, first in the developing world and then, more critically, in the industrialized nations. Paul Holbrook, an executive at London oil consulting firm Gaffney Cline, agrees and points out that it will be five or six years before most of the new North Sea capacity comes on-stream. "Whatever the short-term outlook, there is no need for firms to be panicked in the long run," he says.

To be sure, this brings up the question of whether a new wave of North Sea oil will hinder the very price recovery the oil companies are counting on. A spokesman at OPEC's Vienna headquarters believes it will unless the North Sea companies cut ouput and help restore the market equilibrium. "I would rather like to see them get their comeuppance," he adds.

But most European experts predict that the accumulation of new capacity will not increase North Sea output. Current production is so high, they say, that the net effect will be to hold output more or less steady for the next decade.

In its highly respected oil industry report, The Royal Bank of Scotland forecasts that production in the Norwegian sector will edge up from last year's record 700,000 barrels a day to over 1 million, while British output should decline gradually from last year's record 2.6 million barrels a day to around 2.2 million. "Never mind what the Saudis say," comments David Gray, an energy expert at London securities firm James Capel. "Oil prices will rise or fall regardless of whether output in the North Sea varies."

Right now, with $20 oil a possibility, some oil industry executives have called for the North Sea operators to restrain output to firm prices. Typical of the response, Shell UK Chairman Robert Reed snaps: "We'll pump oil at whatever price the market dictates."

In any case, it would be politically unacceptable in either Britain or Norway to curtail output. As Kaare Kristiansen puts it: "Norway has invested enormous sums of money in its North Sea oilfields and can't shut them down to accommodate OPEC." ■

ILLUSTRATION BY RANDALL ENOS

If you don't read this, you'd better hope someone else does.

Suppose an employee sitting across from you at lunch suddenly started choking. Would you know what to do?

If you, or someone else, didn't act quickly, that person might die. And how can you act quickly, if you don't know what to do?

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So call them. You never know when you'll be glad you did.

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INVESTMENT UPDATE

Here's the current status of a number of investments, and a look at how they have fared over the past month and the past year.

INVESTMENT	(12/31/85) -Recent Price or Yield	Value of $10,000 if invested: Month Earlier	Year Earlier
Common Stock (Index fund, capital gains and dividends reinvested)	$23.00 share	$10,472	$13,129
per cent change		+4.7%	+31.3%
Bonds (30-yr., 11¾% Treasury Bond)			
MARKET VALUE	$118.84	$10,433	$11,781
ACCUMULATED INCOME		$ 86	$ 1,165
TOTAL		$10,519	$12,946
per cent change		+5.2%	+29.5%
Money Market Fund	7.23%	$10,061	$10,771
per cent change		+.6%	+7.7%
Gold (Krugerrands)	$335.70 oz.	$10,254	$10,613
per cent change		+2.5%	+6.1%
HOUSE PRICES	Recent	Month Earlier	Year Earlier
Existing House	$99,500	$95,800	$84,300
per cent change		+3.7%	+15.3%
New House	$108,400	$107,500	$102,600
per cent change		+.8%	+5.4%

Sources: Vanguard Group Inc.; Salomon Brothers; Donoghue's Money Fund Report; Manfra, Tordella & Brookes,Inc.; Federal Home Loan Bank Board.

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compound and is working on antivirals for hepatitis and shingles. The Foundation just completed the initial public offering of 25% of its shares on the London Exchange, which U.S. investors will be able to buy in May.

Despite tumbling petroleum prices, Richards also likes oils. Many British and European oil companies are no longer wholly dependent on oil because they are now highly diversified, he explains. For instance, "BP [British Petroleum Co.] is in cornmeal and shipping and many other businesses in between," he says. With estimated sales last year of £50 billion, BP is selling at a modest 7.16 P/E (recent price: £5.48) and yielding a whopping 16.6%.

Richards also recommends the recently privatized Britoil plc (1985 sales estimate: £1 billion), which is the most active explorer and production company on the U.K. continental shelf of the North Sea. The stock recently traded at £2, yields an eye-popping 26.3% at a P/E of 5.43. In the oil group, he expects that Burmah Oil plc (recently trading at £2.83) will be subject to a takeover bid in the near future.

And he thinks that the big diversified British conglomerates, such as Hanson Trust plc, which has expanded by acquisition, should continue its rapid profit growth—pretax profits tripled from March 1983 to March 1985. A darling of the London Stock Exchange, Hanson's stock recently traded at £2 to yield 10.8%; its P/E was about 13.

Richards would generally steer clear of textiles, engineering and electricals. He makes an exception for STC plc, a telecommunications and consumer electronics conglomerate, with sales in 1985 estimated at £2 billion. STC is undergoing a drastic restructuring, reducing overhead and closing its U.S. manufacturing facility in Utica, New York. Richards believes that "management is showing that determined policies can restore a firm's profitability." Recently, STC's shares fell from £2.89 to £1.04, after it sustained an operating loss in 1985's first half. The P/E is a low 5.2. —DAVID FAIRLAMB